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Wider Troubles Trickle Down to Oil Sector

By Jad Mouawad
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As fears of an American recession ripple across the globe this week, analysts and energy experts are wondering whether the great oil boom of the last five years is finally coming to an end — or whether it is simply taking a break.

While an economic slowdown might lead to lower oil demand, as consumers scale back their gasoline consumption and businesses cut air travel, some economists say this might not necessarily produce lower energy prices. Global oil supplies are tight, geopolitical tensions remain high, and producers are counting on higher prices to offset rising costs.

After briefly touching $100 a barrel twice, oil prices have shed 13 percent since the beginning of the year. Crude oil futures on the New York Mercantile Exchange dropped $2.22 a barrel, or 2.5 percent, to close at $86.99 a barrel on Wednesday, their lowest level since October.

Even as economic growth slows in the United States, some experts fear the world might still find itself confronted with high energy costs, a situation that would be reminiscent of the mid-1970s or the early 1990s. Despite the clouds hanging over the economy, and recent stock market losses, several energy analysts say that oil prices will average $80 a barrel this year, $8 a barrel higher than last year’s average — and nearly double the figure of 2004.

The prospect of a collapse in oil prices, like the one that drove oil to $10 a barrel after the Asian financial crisis in the late 1990s, remains fairly remote. In fact, energy traders are betting on historically high prices into 2010, paying around $83 a barrel for futures contacts that call for delivery of oil in two years.

“The rally of the past few years seems like it is coming to an end,” said Antoine Halff, the head of commodities research at Newedge, a brokerage firm. “But does it mean we’re reverting to the lows we had previously? There are other factors that are providing a floor to prices.”

Efforts to expand oil production are constrained by shortages and rising costs for materials and labor, as well as widespread project delays. Geopolitical tensions in Iraq, Iran and Nigeria — and more restrictive policies in Russia and Venezuela toward foreign investment in oil fields — have hampered production growth from some of the world’s most important suppliers.

“I don’t think we will have a day of reckoning for oil prices because I don’t think we have a bubble,” Mr. Halff said.

Experts are concerned that high energy prices could begin to weigh more heavily on the economy now that lower growth appears to be at hand. On a visit to Cairo on Wednesday, Samuel W. Bodman, the United States energy secretary, told reporters that high prices were starting to hurt the American economy.

“The economy has been able to withstand it until now,” Mr. Bodman said. “I believe the $100 price of oil is starting to have an impact.”

For the moment, the economic slowdown has yet to translate into a significant drop in oil consumption.

Barclays Capital analysts, for example, noted that in China refineries were increasing diesel imports to address severe supply shortages. The analysts say that a series of factors that have pushed up prices in recent years are still in play: commercial oil inventories in industrial nations are lower than their five-year average, new production growth from non-OPEC producers is weak, and slower economic growth means that OPEC nations have little incentive to increase production.

Other commodities also seem to be resisting the economic headwinds. Precious metals like gold, which traditionally act as refuge investments, have benefited from the latest interest rate cut by the Federal Reserve, while demand for aluminum, nickel and iron ore remains robust thanks to developing economies.

Experts say they simply are not sure how the economic slowdown will affect developing countries like China, India, Brazil and Russia, which have been a major source of rising commodity demand.

“There is an awful lot of ambiguity,” said Bart Melek, the global commodity strategist at BMO Capital Markets.

Global demand for oil is still likely to grow this year by about 1.4 million barrels a day, according to forecasts by Lehman Brothers. But some experts say lower economic growth will drive down demand, and therefore prices. Lawrence J. Goldstein, an economist at the Energy Policy Research Foundation, said that from 2005 through 2007, higher prices drove down oil demand in the United States, Europe and Japan by 700,000 barrels a day. He expects global demand to grow by fewer than a million barrels a day this year.

“The three pressure points of the market — the lack of crude oil, the lack of spare refining capacity and the lack of product inventories — are all going to be improving this year,” Mr. Goldstein said. “The problem is what is going to be the real demand growth this year. No one knows for sure.”

New oil supplies, which have lagged demand growth in recent years, are expected to grow by as much as 2.5 million barrels a day, mostly thanks to investments made by members of the Organization of the Petroleum Exporting Countries, including Saudi Arabia, and partly because of increases in Russia. While these increases could help rebuild a cushion of spare capacity that has been lacking recently, analysts still forecast a tight energy system this year.

“The market is still fundamentally well supported,” said Adam J. Robinson, an energy analyst at Lehman, which expects oil prices to average $84 a barrel this year. But prices could fall as low as $65 a barrel if demand dropped sharply.

That would have been considered an extraordinary price a few years ago, but today it is the minimum needed to spur new investments in oil supplies, Mr. Robinson said.